



SENATE BILL 870: Sales & Use Tax on RMI Service Clarified.

2016-2017 General Assembly

Committee:	Senate Finance	Date:	May 31, 2016
Introduced by:	Sens. Rucho, Rabon, Tillman	Prepared by:	Cindy Avrette
Analysis of:	PCS to First Edition S870-CSRbx-59		Committee Co-Counsel

SUMMARY: *The current sales tax on repair, maintenance, and installation services treats similar transactions differently, depending on the classification of the person providing the service and whether the service is for real property or tangible personal property. Senate Bill 870 would do the following:*

- *Treat similar transactions the same.*
- *Identify taxable transactions more clearly.*
- *Provide a grace period for retailers who provide repair, maintenance, and installation services.*

In treating similar transactions the same, the proposed committee substitute would limit the exclusions from the taxable base more narrowly.

CURRENT LAW: Effective March 1, 2016, the General Assembly made three sales tax law changes:

- Repealed the sales tax exemption for installation charges in conjunction with the sale of tangible personal property.
- Expanded the sales tax base to include repair, maintenance, and installation services. (RMI services)
- Expanded the sales tax base to include service contracts on tangible personal property, regardless of whether the tangible personal property is attached to real property.

The sales tax base expansion to RMI services would have expanded the number of people responsible for collecting and remitting the sales tax. To reduce the number of new retailers, the legislation provided that a person who only provides RMI services would not be required to collect and remit the sales tax. It also provided that a person who acts as both a retailer and a real property contractor, commonly referred to as a retailer-contractor, could not be a contractor for sales tax purposes if the majority of the person's gross receipts were derived from retail trade.

The distinctions put into the law to reduce the number of retailers from the base expansion to RMI services treated similar transactions differently, based on the classification of the provider. For example, a person purchases a garage door and has it installed.

- If the garage door is purchased from and installed by a business that engages in retail activity and more than 50% of the business' gross receipts are derived from retail activity, then the transaction is treated as a retail sale + installation and the installation charges are subject to sales tax.

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- If the garage door is purchased from and installed by a business that engages in retail activity and less than 50% of the business' gross receipts are derived from retail activity, then the transaction is treated as a real property contract and the installation of the door is not subject to sales tax.
- If the person purchases the garage door and hires a business to install it and that business only engages in RMI services, then the installation service is not subject to sales tax.
- If the person hires a real property contractor to purchase and install the garage door, then the installation of the door is not subject to sales tax.
- If the person hires a real property contractor to purchase and install the garage door, but the real property contractor has a side business that is a retail business, then the installation service is subject to sales tax, if the person's revenue from the retail business is greater than 50%.

BILL ANALYSIS: The distinctions in the current taxable base created confusion in the application of the new law. To address this confusion and to level the playing field, Senate Bill 870 would treat similar transactions the same, identify taxable transactions more clearly, and provide a grace period for retailers.

Treat similar transactions the same

The proposed committee substitute for Senate Bill 870 would treat similar transactions the same by defining a retailer as anyone who provides RMI services for both real and tangible personal property. Removing these distinctions would mean that all professions that provide RMI services would be retailers and that RMI service for an item attached to real property would be treated the same as the repair or maintenance would be treated if it was provided under a service contract for that item. The removal of the distinction also means the sales tax base would be more far-reaching than it currently is because many RMI services are provided by real property contracts.

Exclude capital improvements

To keep the sales tax base similar to its current application, the proposed committee substitute would exclude from the definition of RMI service tangible personal property installed by a real property contractor under a contract to perform construction or reconstruction with respect to a capital improvement to real property. The bill would define a capital improvement to be new construction or renovation of a building, structure, or fixture on land. Factors to consider in determining whether a contract is for the performance of a capital improvement to real property includes the method of attachment for the property installed, the degree of customization of the property installed, and the value added by or the useful life of the property installed. The bill would define the term "real property" to include a manufactured home or a modular home that is placed on a permanent foundation.

The bill specifically provides that contracts for the following transactions are capital improvements, and the installation and construction of these items would not be subject to sales tax:

- New construction and enlargement of an existing structure.
- Removal of items from real property, such as asbestos and construction material.
- Performance of work that requires a permit under the State Building Code.
- Installation of equipment that is attached to real property and that is capitalized for income tax purposes under the Code.
- Installation of a new unit or system, such as a HVAC system or a new roof.
- Construction and maintenance of a road, parking lot, or sidewalk.
- Landscaping services.

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The bill also provides that the following transactions that are commonly considered a capital improvement would NOT be a capital improvement for sales tax purposes and, absent being part of new construction, would be subject to sales tax:

- Installation of flooring, such as hardwood floors and carpeting.
- Installation of cabinets and countertops.
- Installation of appliances.

The PCS would exempt the following RMI services from sales tax:

- A fee or charge for an inspection required by law. For example, a fee imposed to have a motor vehicle inspected.
- Service performed by a related member. A person is a related member if at least 50% of its value is owned by the entity for who it is providing the RMI service; in this instance, the service is more analogous to a service provided by an employee than a retailer.
- Service performed to resolve an issue that was part of a capital improvement if the services are performed within six months of the completion of the improvement or within six months of a new structure being occupied for the first time. This exemption would include repair services a contractor may have to provide for "punch list" items required of a purchaser of a new structure.
- RMI service for roads, parking lots, and sidewalks. This exemption would treat the repair and maintenance of these items the same as the construction of them. These items are most often State or county-owned in nature and commercial property.
- Removal of items from real property that may be provided on an as-needed basis rather than under a real property contract. Examples include garbage, grease, and debris. The removal of items from tangible personal property or a motor vehicle would be subject to tax.
- Home inspections.
- House cleaning and janitorial services. This exemption would NOT include maintenance services that are not provided as part of an interior cleaning service package. A service that cleans or waxes floors, cleans carpet, or washes windows would be subject to sales tax as a RMI service.

Clarification of RMI services

The current definition of RMI service is to keep or attempt to keep property in working order to avoid break-down and prevent repairs and to restore property to proper working order. To restore property to working order oftentimes involves cleaning the property. The definition of RMI service also includes installing or applying tangible personal property. These words sometimes involve actions one does not necessarily consider "installation", such as planting a tree into the ground or hemming a pair of pants.

Senate Bill 870 would create greater clarity by including in the definition of RMI service the types of services included in the notice sent to taxpayers by the Department of Revenue. Those services include a service to clean, monitor, alter, inspect, modify, or change property or a motor vehicle and to provide pest control for a residential or commercial building or structure. The bill would also make it clear that the maintenance of tangible personal property includes the removal of waste from tangible personal property or a motor vehicle. The bill would make similar wording changes to the definition of a service contract to ensure that the repair or maintenance of an item is treated the same as the provision a repair or maintenance of the same item under a service contract.

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One clarification is the repair and maintenance of a swimming pool. Under current law, the RMI of an item exempt from sales tax is also exempt from sales tax. G.S. 105-164.13(51) exempts water delivered by or through main lines or pipes. The clarification provides that although the water in the pool may be exempt from sales tax, the repair of the pool and the maintenance and monitoring of the water in the pool is subject to sales tax.

Service contract on motor vehicles

Effective March 1, 2016, a service contract on a motor vehicle became exempt from sales tax while the RMI service provided under a service contract on a motor vehicle became subject to tax. An issue arose as to what a service contract on a motor vehicle was. Senate Bill 870 would define a service contract on a motor vehicle as a contract for the repair and maintenance of a motor vehicle or any part, component, or accessory for a motor vehicle sold by a motor vehicle dealer or by or on behalf of a motor vehicle service agreement company. The bill would then specifically exempt a motor vehicle service contract from sales tax. The bill would also exempt all towing services from sales tax. Under the current application of the law, towing provided as part of a repair and maintenance service is included in the sales price of that RMI service. A similar exemption may need to be considered for storage of a motor vehicle waiting to be repaired. Under the current application of the law, the storage fee would be part of the cost of the repair and would be subject to sales tax.

Grace period

Under current law, the Secretary of Revenue may compromise a taxpayer's liability for tax that is collectible when the Secretary determines that the compromise is in the best interest of the State and makes one or more findings listed in G.S. 105-237.1. One of those factors includes that the taxpayer is a retailer and that the assessment is for sales or use tax the retailer failed to collect or pay on an item included in the expansion of the sales tax base to service contracts, admission charges, and real property contracts. Section 1(b) of Senate Bill 870 would include a factor for the expansion of the sales tax base to RMI service. This factor would exist for six years. This is the same period of time that the factor exists for the sales tax base expansion items that were effective January 1, 2014.

Section 1(a) of Senate Bill 870 would also provide that a retailer is not liable for an undercollection of sales and use tax if the retailer made a good faith effort to comply with the law that imposes a sales tax on RMI service for the period beginning March 1, 2016, and ending December 31, 2016.

Section 1(c) of Senate Bill 870 would allow a retailer-contractor who under-paid use tax on an item to offset the amount of tax owed by any over-collection of sales tax remitted on a related transaction. G.S. 105-164.11(a)(2) allows retailers to offset an under-collection of use tax with an over-collection of sales tax remitted on a related transaction; however, this remedy was not available to a retailer-contract. Section 1(c) of Senate Bill makes this remedy effective retroactive to January 1, 2015; that is the effective date of the tax law changes applicable to real property contracts.

Lastly, Section 9 of Senate Bill 870 would direct the Department of Revenue to issue written guidance to taxpayers relative to the tax law changes made in this bill within 120 days of the enactment of this act. The effective date of the tax law changes would be January 1, 2017. The purpose of this section is to give taxpayers and interested parties time to learn of the changes and to be educated regarding the changes before the tax changes become effective.

EFFECTIVE DATE: Except as otherwise provided, this bill would become effective January 1, 2017, and apply to sales made on or after that date.